RUDGE REVENUE REVIEW

ISSUE 5

Spring is in the air and a young man's fancy lightly turns to the Budget. The Budget is later than normal this year for it will not be delivered until the 22nd April. In the meantime we have examined three areas of interest to the private client practitioner.

In our first article we look at the interaction of Entrepreneurs' Relief with other reliefs from Capital Gains Tax, wondering which relief takes priority where the same transaction qualifies both for Hold-Over Relief, Roll-Over Relief on business assets, EIS Deferral Relief or Incorporation Relief and for Entrepreneurs' Relief and we consider whether HMRC's guidance on the matter is consistent with the law.

When the 2008/2009 tax return season begins later this year, advisers will move from the theoretical consideration of the Remittance Basis to having to reflect actual situations in their clients' tax returns. So complex are the required calculations that we think they will carry surprises for many. In our second article, which is based on a lecture delivered to the Private Client Tax Planning conference in February 2009, we provide worked examples of the relief, demonstrating its monstrous complexity.

In the last Rudge Revenue Review we examined the High Court's decision in *Underwood v HMRC*[1] which concerned the nature of a disposal, a concept which is fundamental to the operation of Capital Gains Tax. The Court of Appeal's decision has now been published and is final. We examine that decision in our third article, "A Dark Wood where the Straight Way was Lost".

If you have any questions in relation to any private client tax matter please do not hesitate to telephone us.

We hope that we may have the pleasure of advising you in the near future.

Sharon McKie **Simon McKie**

[1] *Underwood v Commissioners for Her Majesty's Revenue & Customs* [2008] EWHC 108(Ch)

INDEX

SECTION I

THE INTERACTION OF ENTREPRENEURS' RELIEF WITH OTHER RELIEFS FROM CAPITAL GAINS TAX

This article considers the interaction of Entrepreneurs' Relief with Hold-Over Relief, Roll-Over Relief, Enterprise Investment Scheme Deferral Relief and Incorporation Relief.[2]

THE MECHANISM BY WHICH ENTREPRENEURS' RELIEF IS GIVEN

First, it is necessary to understand the mechanism by which Entrepreneurs' Relief is given.

The Sub-section (1) Amount

Under s.169N(1) where a claim for Entrepreneurs' Relief is made 'relevant gains' are to be aggregated as are 'relevant losses.' The aggregate relevant losses are then deducted from the aggregate relevant gains to give what we shall call the "Sub-section (1) Amount".

If the qualifying business disposal concerned is a disposal of shares or securities the relevant gains are the gains accruing on the disposal. Otherwise the relevant gains are the gains accruing on the disposal of any relevant business assets comprised in the qualifying business disposal. Similarly, if the qualifying business disposal is a disposal of shares, relevant losses are any losses accruing on the disposal. Otherwise, they are any losses accruing on the disposal of any relevant business assets comprised in the qualifying business disposal. Both the relevant gains and the relevant losses are to be "computed in accordance with the provisions of … [the Taxation of Chargeable Gains Act 1992]… fixing the amount of chargeable gains." Relevant losses are computed on the assumption that notice has been given to HMRC quantifying the amount of the losses.[3]

The Sub-section (2) Amount

Sub-section (2) then provides that the resulting amount is to be reduced by four ninths, except that if the Sub-section (1) Amount added to all previous such amounts of the disponer exceeds £1 million, the reduction is capped. It is to be made in respect of only so much (if any) of the Sub-section (1) Amount as, when added to the total of the previous Sub-section (1) Amounts, does not exceed £1 million.[4]

The amount found in accordance with sub-section (2) we shall call the "Sub-section (2) Amount".

---

2 All references in this article are to the Taxation of Chargeable Gains Act 1992 unless otherwise stated
3 Sections 164N(5) & (6)
4 Sub-section (2) ibid

The Charge

The Sub-section (2) Amount is to be treated for the purposes of Capital Gains Tax as a chargeable gain accruing at the time of the disposal to the individual or trustees by whom the claim is made.[5] Any gain or loss taken into account in calculating the relevant gains and relevant losses is not to be taken into account for Capital Gains Tax purposes as a chargeable gain or an allowable loss.[6]

So the mechanism by which the relief is given is to substitute a deemed gain which accrues at the time of the actual disposal but does not arise on it for the actual gains which would otherwise be chargeable and to provide that the actual gains are not to be taken into account as chargeable gains and the actual losses are not to be taken into account as allowable losses.

Example I

Mr Tremlett has previously claimed Entrepreneurs' Relief in respect of Sub-section (1) Amounts of £500,000 in aggregate. He now claims relief in respect of a qualifying disposal of his cider making business on which he made the following gains and losses:-

	£000
The Dabinett Orchard	400
The Pigsnout Orchard	<100>
Goodwill	300
Plant	50

His relevant gains are, therefore, £750,000 (£400,000 + £300,000 + £50,000) and his relevant losses are £100,000. His Sub-section (1) Amount is therefore £650,000 (£750,000 - £100,000). Adding this Sub-section (1) Amount to the aggregate of his previous Sub-section (1) Amounts gives a total of £1,150,000. The reduction under sub-section (2) is restricted to 4/9ths of so much of the Sub-section (1) Amount on the disposal as, when added to the aggregate previous Sub-section (1) Amounts, does not exceed £1,000,000. So the relief is calculated on £500,000 (£1,000,000 - £500,000) and The Sub-section (2) Amount is £427,778 (£650,000 – (£500,000 x 4/9)).

5 Sub-section (4) ibid
6 Sub-section (9) ibid

So Mr Tremlett is deemed to realise a chargeable gain of £427,778 on the date of his disposal of the cider making business. The actual gains arising on the disposals of the Dabinett Orchard, the goodwill and the plant are not chargeable gains and the loss on the disposal of the Pigsnout Orchard is not an allowable loss.

Hold-Over Relief

Where Hold-Over Relief is claimed under s.165 on a disposal of business assets or under s.260 on a disposal on which inheritance tax is charged:-

> "(a) the amount of any chargeable gain which, apart … [from the application of Hold-Over Relief to the disposal] … would accrue to the transferor on the disposal; and
>
> (b) the amount of the consideration for which, apart … [from the relief] … the transferee would be regarded for the purposes of Capital Gains Tax as having acquired the asset ….
>
> shall each be reduced by an amount equal to the held-over gain on the disposal."[7]

The held-over gain on the disposal is the chargeable gain which would have accrued on that disposal ignoring Hold-Over Relief itself.[8]

If a claim is made in respect of the same disposal for both Entrepreneurs' Relief and Hold-Over Relief, what Hold-Over Relief and what Entrepreneurs' Relief would be given?

Entrepreneurs' Relief

We have seen that the first step in computing the deemed chargeable gain which is substituted for the actual gains by ss.169N(4) & (9) is to aggregate the relevant gains. We have also seen that relevant gains are the gains accruing on the actual disposals constituting the qualifying business disposal in respect of which the claim is made "computed in accordance with the provisions of … [the Taxation of Chargeable Gains Act 1992] … fixing the amount of chargeable gains …" Does this mean that the aggregate relevant gains are themselves chargeable gains? That cannot be the case because the provision would then contain a circularity. If 'gains' in the definition of 'relevant gains' meant chargeable gains, one would have to determine the amount of the chargeable gains in order to determine the relief and one would have to determine the relief in order to determine the chargeable gains. Other Capital Gains Tax reliefs deal with this problem by specifically providing that the relief itself is to be ignored in calculating the chargeable gains by reference to which the relief is computed. We have already seen that this is the method adopted for Hold-Over Relief.[9]

---

7 Section 165(4) and s.260(3)
8 Section 165(6) and s.260(4)
9 Section 165(6) and s.260(4). In relation to EIS Deferral Relief see Sch 5B para 1(1)(a)

So it is clear that if the relevant gains are "computed in accordance with the provisions of … [the Taxation of Chargeable Gains Act 1992] … fixing the amount of chargeable gains" then the relevant gains must be gains which are computed at a prior stage of the process which results in determining chargeable gains. It is quite clear, from other parts of the Capital Gains Tax code, that a reference to a gain is not necessarily a reference to a 'chargeable gain'. For example, s.115 provides that a gain which accrues on a disposal of gilt edged securities or qualifying corporate bonds 'shall not be a chargeable gain'. It seems clear, therefore, that the relevant gains which are aggregated under s.169N(1) are gains determined at an antecedent stage to the stage at which one determines whether the gains are chargeable or not. As Hold-Over Relief operates, under s.165(4) by reducing the chargeable gain, the claim for Hold-Over Relief will not affect the amounts by reference to which the deemed chargeable gain brought into charge by s.169N(4) is calculated.

Hold-Over Relief

Turning to Hold-Over Relief, we have seen that that relief operates by reducing the amount of any chargeable gain which, were it not for the relief, would accrue to the transferor on the disposal. The disposal concerned must be the disposal of an asset referred to in s.165(1) (or in s.260(1)). That is it must refer to the actual disposal. We have seen that, where Entrepreneurs' Relief is claimed on a disposal, s.169N(4) treats a freestanding amount (albeit one calculated by reference to the actual gains arising on the disposals in relation to which the claim is made) as a chargeable gain accruing at the time of the actual qualifying business disposal but it does not deem this gain to accrue 'on' the disposal.

The result of that is that, if there is a disposal in relation to which both Entrepreneurs' and Hold-Over Relief is claimed, there would be no chargeable gain which, apart from Hold-Over Relief, would accrue to the transferor on the disposal because Entrepreneurs' Relief has the effect that the gains arising on the actual disposals are not chargeable gains; rather a computed amount which does not arise on any particular disposal is treated as a chargeable gain accruing to the claimant.

So it is not possible to receive both Hold-Over Relief and Entrepreneurs' Relief in respect of the same disposal. Of course, if Hold-Over Relief were more favourable, it could be substituted for Entrepreneurs' Relief by the simple expedient of claiming the former and not the latter. It should be noted, however, that a claim for Entrepreneurs' Relief in relation to a qualifying business disposal consisting of, for example, the disposal of a business has effect in respect of all of the assets comprised in that business. So it is not possible to choose to have Entrepreneurs' Relief on some of the disposals comprised in the qualifying business disposal and Hold-Over Relief on others.

Returning to the facts in Example 1, Mr Tremlett must choose between claiming Entrepreneurs' Relief on all of the business assets in the Example or on none of them. He could not, for example, claim Entrepreneurs' Relief in respect of the goodwill and plant and Hold-Over Relief in respect of the Dabinett Orchard.

HMRC's view of the interaction of Entrepreneurs' Relief and Hold-Over Relief

What is HMRC's view on this? Their Capital Gains Manual says:-

> "If the whole of the assets comprised in the 'material disposal' for the purposes of Entrepreneurs' Relief are gifted and the subject of a claim under TCGA192/S165 then no chargeable gain will arise at that time. In consequence there will be no 'relevant gain' for the purposes of TCGA92/S169N (1) – see CG64125 – and a claim to Entrepreneurs' Relief would not be appropriate.
>
> If however only part of the assets comprised in the 'material disposal' for the purposes of Entrepreneurs' Relief are gifted and the subject of a claim under TCGA192/S165 then a chargeable gain will remain at that time and a claim to Entrepreneurs' Relief may be made in respect of the amount of gain that remains chargeable."[10]

On the face of it, the extract simply does not address the point. The question is not whether or not a claim to Entrepreneurs' Relief would "be appropriate" where a Hold-Over Relief claim has been made in respect of the same disposal but what is the result of making both claims? But the reasons advanced in the extract for HMRC's view imply that they think that the relevant gains under s.164N are chargeable gains and, therefore, that they will have been reduced by Hold-Over Relief before they are aggregated under s.164N(1).

When there is actual consideration for the disposal which exceeds the sums deductible under s.38, Hold-Over Relief is restricted with the result that a gain remains in charge after the deduction of the relief.[11] The logic of the position taken in HMRC's guidance is that Entrepreneurs' Relief relieves such a gain although the guidance does not deal with the matter specifically.

ROLL-OVER RELIEF ON BUSINESS ASSETS

Where a person claims Roll-Over Relief on business assets under s.152 he is treated:-

> "as if the consideration for the disposal of, or of the interest in, the … assets [which were the subject of the disposal] were (if otherwise of a greater amount or value) of such amount as would secure that on the disposal neither a gain nor a loss accrues to him …"

Here, it is the consideration received for the disposal and not the chargeable gain which is reduced and the reduction is calculated so as to ensure that no gain (not, no chargeable gain) arises on the disposal. Because it is the consideration which is reduced and because the reduction is not calculated by reference to the chargeable gain which would otherwise accrue on the disposal, the relevant gains taken into account under s.169N(1) for the purposes of

---

10 CG64137. It is interesting that the authors of *Revenue Law – Principles and Practice* (26th Edition – Tottel) agree that Entrepreneurs' Relief takes priority over Hold-Over Relief but seem to be of the opinion that Hold-Over Relief can be claimed in respect of the sub-section (2) amount chargeable under s.164N(4). The grounds of this opinion are not given (para 20.86 ibid)

11 Section 165(7) and s.260(5)

calculating Entrepreneurs' Relief will be the gains reduced by the claim for Roll-Over Relief on business assets.

So in effect, Roll-Over Relief on business assets will take priority over a claim for Entrepreneurs' Relief.[12] Roll-Over Relief on business assets will normally reduce the gain on the disposal in respect of which it is claimed to nil in which case Entrepreneurs' Relief cannot further reduce that gain.

Where, however, only a part of the consideration received on the disposal of the old asset is applied in acquiring the new asset, the gain accruing on the disposal will be equal to the amount of the consideration which is not applied to acquiring the new asset.[13] In that case the gains which remain in charge can form part of the relevant gains which are taken into the computation required for Entrepreneurs' Relief. It is also possible to receive Hold-Over Relief on the disposal of some of the relevant business assets comprised in a qualifying business disposal in respect of which a claim to Entrepreneurs' Relief is made.

Examples

To return to our example, if Mr Tremlett had invested the entire proceeds of his disposal of the Dabinett Orchard in assets qualifying for Roll-Over Relief on business assets he could have rolled over the gain on the Dabinett Orchard against his acquisition. In that case, he would be treated for Capital Gains Tax purposes as if the consideration for the disposal of the Dabinett Orchard had been such an amount as did not result in a gain accruing with the result that his relevant gains under s.169N(1) would have been reduced to £350,000 (£300,000 + £50,000) and therefore his Sub-section (1) Amount would have been reduced to £250,000 (£350,000 - £100,000). This Sub-section (1) Amount would then have been reduced by 4/9th giving a Sub-section (2) Amount of £138,889 (£250,000 - (£250,000 x 4/9)).

If we vary the example slightly again, we can illustrate the application of s.153. If Mr Tremlett had not invested the whole of the consideration of the Dabinett Orchard in assets qualifying for Roll-Over Relief but, say, all but £50,000 of it, the Roll-Over Relief on the disposal of the Dabinett Orchard would have been governed by s.153 so that the gain accruing on the disposal would have been £50,000. In that event, the relevant gains for the purposes of s.164N(1) would have been £400,000 (£50,000 + £300,000 + £50,000) and therefore The Sub-section (1) Amount would have been £300,000 (£400,000 - £100,000) and The Sub-section (2) Amount would have been £166,667 (£300,000 – (£300,000 x 4/9)).

HMRC's view of the interaction of Entrepreneurs' Relief and Roll-Over Relief on business assets

What is HMRC's view of this interaction of the two reliefs? Their Capital Gains Manual says the following:-

---

12 The authors of *Revenue Law - Principles and Practice* (26th Edition – Tottel) agree that "Roll-Over Relief … applies before Entrepreneurs' Relief" (para 20.86 ibid)

13 Section 153

> "If the whole of the gain accruing upon the disposal of the old asset is rolled-over against the acquisition cost of the new asset then no chargeable gain will arise at that time. In consequence there will be no 'relevant gain' for the purposes of TCGA92/S169N (1) – see CG64125 – and a claim to Entrepreneurs' Relief would not be appropriate.
>
> If however only part of the gain accruing upon the disposal of the old asset is rolled-over against the acquisition cost of the replacement asset then a chargeable gain will remain at that time and a claim to Entrepreneurs' Relief may be made in respect of the amount of gain that remains chargeable."

This is correct as far as it goes, but it does not address the situation where the qualifying business disposal for Entrepreneurs' Relief purposes consists of several disposals of chargeable assets and Roll-Over Relief claims are made in relation to some but not all of those disposals.

Enterprise Investment Scheme Deferral Relief

Where Enterprise Investment Scheme Deferral Relief ("EIS Deferral Relief") under s.150C and Sch 5B is claimed in respect of a disposal, the relief primarily operates by setting an amount "against a corresponding amount of the original gain".[14] The 'original gain' is the chargeable gain which would accrue to the claimant on the disposal apart from the operation of EIS Relief.[15] If this were the only way in which EIS Deferral Relief were conferred, Entrepreneurs' Relief would exclude EIS Deferral Relief as it does Hold-Over Relief. That is because, as EIS Deferral Relief operates by reducing the chargeable gain which would otherwise accrue on the disposal, if both Entrepreneurs' Relief and EIS Deferral Relief were claimed in respect of the same disposal, Entrepreneurs' Relief would (were it not for the provision discussed below) result in the EIS Deferral Relief being reduced to nil. That is because, if no EIS Deferral Relief were claimed, s.164N(9) would have the effect that no chargeable gains would accrue on the disposal.

Sch 5B para 1(1) provides that the relief applies if:-

> "(a) there would (apart from paragraph 2(2)(a) below) be a chargeable gain ("the original gain") accruing to an individual ("the investor") at any time ("the accrual time") on or after 29th November 1994;
> (b) the gain is one accruing either on the disposal by the investor of any asset or in accordance with section 164F or 164FA, section 169N, paragraphs 4 and 5 below or paragraphs 4 and 5 of Schedule 5C"

and certain other conditions are met.

So specific relief is given for gains arising under s.164N(4). For that relief the relieved gain is not required to arise on a disposal and operates by reducing the chargeable gain which would otherwise arise.

---

14 Schedule 5B para 2(1)
15 Schedule 5B para 1(1)(a)

The relevant gains for Entrepreneurs' Relief will not be reduced by EIS Deferral Relief and therefore Entrepreneurs' Relief will take priority over EIS Deferral Relief. EIS Deferral Relief, however, will then relieve the gain chargeable under s.164N(4); that is the gain which has had the benefit of Entrepreneurs' Relief.[16]

These provisions of EIS relief give further support to our conclusions on the interaction of Entrepreneurs' Relief and Hold-Over Relief. For, if we were wrong in considering that the gain assessable under s.164N(4) does not arise on actual disposals, there would be no need for Sch 5B(1)(b) to give specific relief for gains under that subsection; the relief would be available in any event because there would "be a chargeable gain … accruing on the disposal by the investor of any asset …".

HMRC's view of the interaction of Entrepreneurs' Relief and EIS Deferral Relief

HMRC's view of the interaction of the two reliefs is as follows:-

> "Where a gain arises and Entrepreneurs' Relief is claimed it is possible that a claim may also be made under a provision which postpones or defers the CGT charged until the occurrence of a future event, such as EIS Deferral Relief under TCGA92/SCH5B In these circumstances the amount of the postponed or deferred gain is the gain after any Entrepreneurs' Relief is given.
>
> Where the postponement or deferral provision limits the gains attracting that relief to the lesser of the:
>
> - chargeable gain arising upon the disposal of the 'old asset', or
> - the consideration applied on the acquisition of the new asset,
>
> then the chargeable gain applicable for the purpose of the first bullet, where a valid claim to Entrepreneurs' Relief is made, is the 'chargeable gain' after the 4/9th Entrepreneurs' Relief reduction has been made."[17]

So HMRC's position seems to be that where claims to both reliefs are made in respect of the same disposal, Entrepreneurs' Relief will be given first and EIS Deferral Relief will then reduce the gain after Entrepreneurs' Relief. It therefore agrees with the analysis which is given above.

<u>Incorporation Relief</u>

Where a business is transferred to a company as a going concern in exchange for shares (the "New Assets"), Incorporation Relief under s.162 may be claimed.

---

16 The authors of *Revenue Law - Principles and Practice* (26th Edition – Tottel) agree that "EIS Deferral Relief … applies after Entrepreneurs' Relief" (para 20.86 ibid)

17 CG64135

In that case, an amount determined under s.162(4) (the "Section 162(4) Amount") is deducted from the aggregate of the chargeable gains less allowable losses arising on the disposals of the assets comprised in the business (the "Old Assets").[18] This aggregate is called "the Amount of the Gain on the Old Assets". The sums allowed as a deduction under s.38(1)(a) in respect of the New Assets are also reduced by the amount.[19]

The Section 162(4) Amount is found by applying a fraction to the Amount of the Gain on the Old Assets. If the result exceeds the cost of the New Assets, the amount is restricted to that cost.[20]

It can be seen, therefore, that the starting point of the computation of the amount of relief is the aggregate of the chargeable gains less allowable losses arising on the disposals of the Old Assets. Similarly to Hold-Over Relief, therefore, because Incorporation Relief is calculated by reference to the chargeable gains which arise on the actual disposals of the assets comprised within the business, where Entrepreneurs' Relief is also claimed, the amount of those chargeable gains and therefore of the s.162(4) amount will be nil. As we have seen, that is because s.164N(9) provides that the gains on the actual disposals are not to be chargeable gains.

Once again, if Incorporation Relief is more favourable than Entrepreneurs' Relief, Incorporation Relief can be substituted for Entrepreneurs' Relief by the simple expedient of not claiming Entrepreneurs' Relief.[21]

HMRC's view of the interaction of Entrepreneurs' Relief and Incorporation Relief

Strangely, unlike the other reliefs considered in this article, the Capital Gains Tax Manual does not give HMRC's view of how Incorporation Relief interacts with Entrepreneurs' Relief. The authors understand, however, that, in correspondence, HMRC have advanced the view that Incorporation Relief under s.162 "takes precedence" over Entrepreneurs' Relief.[22] The correspondence suggests that the grounds of this view are that relevant gains for Entrepreneurs' Relief purposes are chargeable gains. As we have seen, however, regarding "relevant gains" as being themselves chargeable gains is inconsistent both with the mechanics of s.164N and with Sch 5B para 1(1)(b).

---

18 Section 162(2)
19 Section 162(3)
20 Section 162(4)
21 Incorporation Relief under s.162, of course, applies automatically and does not have to be claimed although it is possible to disclaim the relief under s.162A
22 The authors of *Revenue Law - Principles and Practice* (26th Ed – Tottel) appear to agree with HMRC's position but do not give their grounds for doing so (para 20.86 ibid)

A summary of how Entrepreneurs' Relief interacts with the other Capital Gains Tax reliefs

RELIEF	EFFECT OF STATUTORY PROVISIONS	HMRC'S VIEW
Hold-Over Relief	Entrepreneurs' Relief excludes Hold-Over Relief if both are claimed.	Hold-Over Relief takes priority over Entrepreneurs' Relief. It would appear to be a logical consequence of this view that Entrepreneurs' Relief can reduce the gain after Hold-Over Relief if Hold-Over Relief is restricted under s.165(7) or s.260(5).
Roll-Over Relief on business assets	Roll-Over Relief on business assets takes priority over Entrepreneur's Relief. If Roll-Over Relief does not reduce the gain on the disposal to nil, Entrepreneurs' Relief will apply if both reliefs are claimed.	Roll-Over Relief on business assets takes priority over Entrepreneur's Relief. If Roll-Over Relief does not reduce the gain on the disposal to nil, Entrepreneurs' Relief will apply if both reliefs are claimed.
Enterprise Investment Scheme Deferral Relief	Entrepreneurs' Relief takes priority over EIS Deferral Relief but the gain chargeable under s 169(4) may be relieved by EIS Deferral Relief if both reliefs are claimed.	Entrepreneurs' Relief takes priority over EIS Deferral Relief but the gain chargeable under s 169(4) may be relieved by EIS Deferral Relief if both reliefs are claimed.
Incorporation Relief	Entrepreneurs' Relief excludes Incorporation Relief if Incorporation Relief applies and Entrepreneurs' Relief is claimed.	Incorporation Relief "takes precedence" over Entrepreneurs' Relief.

SECTION II

UK RESIDENT NON-UK DOMICILIARIES – MANAGING THE FA 2008 REGIME TO ADVANTAGE

INTRODUCTION

The Pre-Budget Report 2007 seems an age away. So much has happened since then in the economy that the agitation over the taxation of private equity and the strange political manoeuvrings which led to the introduction of the Remittance Basis Charge seems like a tale of another age.

The new regime is monstrously complex and it is only in its application to concrete examples that one can see its implications. So this article considers a series of examples illustrating its operation in detail.

APPLICATION OF THE REMITTANCE BASIS: SECTIONS 809B – 809E[23]

An Example

Example I

Senor Sidoli[24] became resident in the United Kingdom in the fiscal year 2001/02 together with his wife Maria and his youngest son Giovanni, who was born on the 31st May 1991. They have remained resident and ordinarily resident in the UK since that time. His eldest son, Guiseppe, who was born on the 31st August 1985, remained in Italy to complete his schooling until the 30th June 2003 so that he became resident and ordinarily resident in 2003/04 and thereafter.

None of the family made any capital gains in 2008/09 nor had any employment income for that year nor had they remitted any income or capital gains in respect of previous years. Their investment income for the year was as follows:-

[23] All reference in these notes are to ITA 2007 unless otherwise stated

[24] All characters in the examples in this lecture are not domiciled in a country of the United Kingdom and are resident and ordinarily resident here unless otherwise stated. They have made an election under s.809B to which s.809C applies for all relevant years unless otherwise stated

NAME	UK INCOME £	OVERSEAS INCOME ARISING IN YEAR £	OVERSEAS INCOME REMITTED IN YEAR £
Paolo	100,000	500,000	300,000
Maria	Nil	4,000	2,500
Giovanni	1,000	30,000	2,500
Guiseppe	0	30,000	2,500

Paolo makes a claim for the remittance basis to apply. Section 809B applies to him for 2008/09 because he is UK resident in that year, he is not domiciled in the United Kingdom in that year and he has made a claim under that section. He is also within s.809C so he must nominate the income to which the Remittance Basis Charge is to apply.

Maria falls within s.809D for 2008/09 because she is resident in the UK but not domiciled here in that year and her unremitted foreign income and gains are less than £2,000 (£4,000 – £2,500).

Giovanni does not fall within s.809E because he has UK source income. He therefore makes a claim under s.809B. He does not fall within s.809C because he is not eighteen years of age or over at any time in 2008/09.

Guiseppe also doesn't fall within s.809E because he has remitted income and gains to the United Kingdom. He therefore makes a claim under s.809B. He does not fall within s.809C because he has not been UK resident for at least seven of the nine years immediately preceding 2008/2009.

The result is that the remittance basis applies to every member of the Sidoli family in 2008/09 but the Remittance Basis Charge applies only to Paolo.

THE EFFECT OF THE REMITTANCE BASIS ELECTION: SECTIONS 809F AND 809G

An Example

Example II

This example considers the effects of the remittance basis by comparing the results of making and not making the election. Mr Reinette has the following income and gains:-

	INCOME AND GAINS	INCOME AND GAINS ARISING AND RECEIVED IN UK
	£	£
UK Employment Income	250,000	250,000
Gains on UK situated Assets	10,000	10,000
Foreign dividends not from minority holdings	50,000	5,000
Foreign dividends from minority holdings	27,000	5,400
Interest on foreign bank accounts	20,000	0
Capital Gains on assets situated outside the UK	8,000	0
	365,000	**270,400**

N.B. Unremitted income and gains are £94,600.

Taxation Calculation without Remittance Basis

	£	
Income Tax		
UK employment income	250,000	
Foreign dividends not from minority holdings	50,000	
Foreign dividends from minority holdings 27,000 x 10/9	30,000	
Interest on foreign bank account	20,000	
Total income	350,000	
Less personal allowance	6,035	
Total income after personal allowance	343,965	
Income Tax thereon:-		
34,800 @ 20%	6,960	
80,000 @ 32.5%	26,000	
229,165 @ 40%	91,666	
	124,626	
Tax credit (£27,000 x 1/9)	<3,000>	
Total Income Tax liability		**121,626**

Capital Gains Tax

Capital Gains	18,000	
Less: annual exemption	9,600	
Excess of taxable amount over annual exemption	8,400	
Capital Gains Tax @ 18%		1,512
Combined Income and Capital Gains Tax if no election is made		£123,138

Taxation Calculation with Remittance Basis Election[25]

	£	
Income Tax		
UK employment income	250,000	
Non-qualifying foreign dividends	5,000	
Qualifying foreign dividends		
5,400 x 10/9	6,000	
	261,000	
Income tax thereon:-		
34,800 @ 20%	6,960	
226,200 @ 40%	90,480	
	97,440	
Tax credit (£6,000 - £5,400)	<600>	
Total Income Tax Liability		**96,840**

Capital Gains Tax

Capital Gains	10,000	
Capital Gains Tax 18%		1,800
Additional tax assessable under Section 809H		30,000
		128,640
Less tax if no election had been made		123,138
Increase in tax due to election		£5,502

[25] The amounts assessable under s.809H are shown separately below

RECONCILIATION

	£	£
Tax saved on unremitted income		
Foreign dividends not from minority holdings ((£50,000 - £5,000) @ 32.5%)	14,625	
Foreign dividends from minority holdings ((£30,000 - £6,000) @ 32.5%) – ((£30,000 - £6,000) ÷ 10)	5,400	
Interest on foreign bank account (£20,000 – 0) @ 40%	8,000	
		<28,025>
Loss of personal allowance		
£6,035 @ 40%		2,414
Loss of 32.5% rate on foreign dividends		
(£5,000 + £6,000) @ (40% - 32.5%)		825
Tax saved on unremitted gains		
£8,000 @ 18%		<1,440>
Loss of CGT annual exemption		
£9,600 @ 18%		1,728
Remittance Basis charge		30,000
		5,502

EFFECT ON WHAT IS CHARGEABLE – CAPITAL LOSSES

TCGA 1992 Sections 16ZA – 16ZD

Section 16ZA

Section 16ZA provides that an election may be made in "the relevant tax year". The relevant tax year is the first year for which:-

(a) a claim for the Remittance Basis is made; and

(b) the individual is not domiciled in the United Kingdom.

The second condition is puzzling as it is a condition of making a claim for the Remittance Basis under s.809B that an individual should not be domiciled in the United Kingdom.

If no election is made in the relevant tax year it cannot be made in respect of subsequent years. There is, however, a long period to decide whether or not the election should be made because the time limit is the standard one in TMA 1970 s.43, being five years after the 31st January next following the year of assessment to which it relates.

If the individual does not make an election, foreign losses accruing to him in:-

(a) the relevant tax year; or

(b) any subsequent tax year except one in which he is domiciled in the United Kingdom

are not allowable losses.

Note that this would disallow losses even in a year in which a taxpayer has not made the Remittance Basis election.

Section 16ZB

Where the election is made, s.16ZB has the effect that losses cannot be set off against foreign chargeable gains which have arisen in a previous tax year but which are treated as accruing in a later tax year by reason of their remittance.

This is so whether or not the individual has made a Remittance Basis election for the year concerned.

Section 16ZC

Section 16ZC applies to an individual for a tax year if:-

(a) the individual has made an election under s.16ZA;
(b) the Remittance Basis applies to the individual for that tax year; and
(c) the individual is not domiciled in the United Kingdom in the tax year.

Where the section applies, a series of steps are specified for the purpose of calculating the amount on which an individual is to be charged to Capital Gains Tax for the tax year. Under those steps, allowable losses are deducted first from foreign chargeable gains accruing to the individual in the tax year which have been remitted in that year. Secondly, they are deducted from foreign chargeable gains accruing to the individual in that year to the extent that they have not been so remitted. Thirdly, they are deducted from other chargeable gains accruing to the individual in that year. In arriving at a taxpayer's gains chargeable to Capital Gains Tax for the year, however, the losses deducted from foreign chargeable gains accruing to the individual in that year which have not been remitted in the year are ignored.

The result is that losses set against foreign chargeable gains which are not remitted in the year are regarded as having been used and therefore cannot relieve other gains and, in particular, chargeable gains on disposals of UK situated assets.

AN EXAMPLE

Example III

Mr Umaga makes the following gains, losses and remittances. His foreign income is sufficiently large so that it is clear that it will be advantageous for him to make the Remittance Basis election in 2008/2009 and 2009/2010. His income is less in 2010/2011 so he needs to determine his capital gains tax position in order to determine whether or not to make the Remittance Basis election. He makes an election under TCGA 1992 s.16ZA. His capital gains, losses and remittances of gains in the years 2008/2009 – 2010/2011 are as follows.

Year	Gains		Losses		Remittances of Gains realised in:		
	UK	Foreign	UK	Foreign	2008/09	2009/10	2010/11
2008/09	100,000	0	0	200,000	0	N/A	N/A
2009/10	0	500,000	400,000	0	0	0	N/A
2010/11	0	500,000	0	0	0	500,000	200,000

No election under Section 16ZA

2008/2009	**£**	
Capital Gains (UK)	100,000	
Allowable losses	0	(foreign losses are not deductible)
	100,000	

2009/2010	**£**
Capital Gains	0

2010/2011	**£**
Capital gains (500,000 + 200,000)	700,000
Less losses brought forward	<400,000>
	300,000

Election under Section 16ZA

2008/2009

Section 16ZB does not apply because foreign chargeable gains have not accrued on or after the relevant tax year (2008/2009) but before the applicable tax year (2008/2009). Section 16ZC applies.

Capital Gains	100,000
Foreign losses deducted from non-foreign chargeable gains	<100,000>
	0

2009/2010

Section 16ZB does not apply because foreign chargeable gains have not accrued on or after the relevant tax year (2008/2009) but before the applicable tax year (2009/2010). Section 16ZC applies.

Apply steps in s.16ZC(2).

Step I	**Foreign chargeable gains arising and remitted in year (a)**	**Other foreign chargeable gains accruing in the year (b)**	**Other gains accruing in the year (c)**
	£	**£**	**£**
Gains	0	500,000	0
Losses deducted			
Foreign losses BF (200,000 – 100,000)			
UK losses of the year (400,000)	<0>	<500,000>	0

Step II

The chargeable amount is equal to aggregate chargeable gains (£0) less losses deducted under (a) and (b) above (£0). So the chargeable amount for the year is nil.

2010/2011

Section 16ZB and Section 16ZC apply.

Step I

	Foreign chargeable gains arising and remitted in year	**Other foreign chargeable gains accruing in the year**	**Other gains accruing in the year**
	£	**£**	**£**
Gains	200,000	300,000	0
Losses offset	0	0	0

Unremitted gains carried forward are £300,000 of the gains arising in 2010/2011.

If he does not make the Remittance Basis election he will be taxed on the full £500,000 of foreign gains which arose in the year. By making the election he is taxed on only the £200,000 of those gains which were remitted in the year.

Mr Umaga is taxable on the aggregate of:-

		£
(a)	The adjusted taxable amount	200,000
(b)	The relevant gains (the gains realised in 2009/2010 were reduced by the set off of losses in 2009/2010 under Step I of s.16ZC(2))	0
	Amount on which Capital Gains Tax is chargeable	200,000

	Without Election	With Election
	£	£
Aggregate gains on which CGT is chargeable in 2008/2009 – 2010/2011	400,000	200,000
Allowable losses carried forward at 6th April 2011	0	0
Realised but unremitted gains at 6th April 2011	300,000	300,000

Making the election allows the foreign losses made in 2008/2009 to be utilised. One might not make the election in circumstances where one wants losses to be set-off against UK gains rather than unremitted gains.

THE REMITTANCE BASIS CHARGE: SECTION 809H

An Example

Example IV

Mr Chabal has the following income and gains in 2008/2009.

	Income and gains arising in year	Remittances of income and gains arising in year[26]	Foreign tax suffered
	£	£	£
UK capital gains	10,000		
Foreign source interest income	20,000		10,000
Foreign source dividend income not on a 'minority holding'	40,000	35,000	
Foreign capital gains	170,000		30,000

Mr Chabal, seeing that he has unremitted income and gains of £195,000 makes the remittance basis election nominating the foreign source interest income and the foreign capital gains.

Under s.809H(2) Income Tax and Capital Gains Tax are calculated as if the nominated income and gains were not subject to the Remittance Basis.

[26] No income or gains from prior years were remitted in the year

	Arising Basis	Remittance Basis	Total
Income Tax			
Foreign interest (grossed up for foreign tax)	30,000	-	30,000
Foreign dividends	-	35,000	35,000
Total income			£65,000
Less personal allowance[27]			6,035
			58,965
Tax thereon:-			
At 20% on 34,800			6,960
At 40% on 24,165			9,666
			13,626
Less double tax relief			<10,000>
			£3,622
Capital Gains Tax			
Gains in year (£200,000[28] + £10,000)	210,000	-	210,000
Capital Gains Tax thereon at 18%			37,800
Less double tax relief			<30,000>
			7,800

Under s.809H(4) & (5) one then makes a comparison with the tax liability which would have arisen if the nominated income were not included in taxable income.

Income Tax	**£**
Foreign dividend income	35,000
	35,000
Tax thereon:-	
At 20% on 34,800	6,960
At 40% on 200	80
	7,040

[27] Under s.809H(2) the Income Tax charged on the nominated income and gains is charged as if s.809B did not apply to the individual in the year so it is only from the nominated income that one can deduct the personal allowance. If this personal allowance had exceeded the nominated income, the excess could not have been deducted from the foreign dividend income

[28] Grossed up for foreign tax

Capital Gains Tax

Gains in year	10,000
Capital Gains Tax thereon at 18%	1,800

Relevant tax increase (s.809H(5))

Liability including nominated income (3,622 + 7,800)	11,422
Liability excluding nominated income (7,040 + 1,800)	8,840
	2,582

Deemed increase to nominated income under s.809H(4)

(£30,000 - £2,582) x 100/40	68,545

Mr A's Liability for the Year

Liability including actually nominated income	11,422
Liability on income deemed to be nominated under s.809H(4) (68,545 @ 40%)	27,418
	38,840

Should Mr A have made an election under s.809B?

Liability without Election

Income Tax	**£**
Foreign source interest	30,000
Foreign source dividends	40,000
	70,000
Less personal allowance	6,035
	63,965
Tax thereon:-	
At 20% on 30,000	6,000
At 10% on foreign dividends of 4,800	480
At 32.5% on 29,165	9,479
	15,959

Less double tax relief	<10,000>
	5,959

Capital Gains Tax

Total gains	210,000
Annual exemption	9,600
	200,400
Capital Gains Tax at 18%	36,072
Less: double tax relief	<30,000>
	6,072

Total tax liability on an arising basis

Income Tax	5,959
Capital Gains Tax	6,072
	12,031

Why has the Remittance Basis claim proved to be unfavourable, in spite of the fact that Mr Chabal has unremitted gains of £195,000? These are four reasons. First, he has lost the personal allowance. Second, he has lost the Capital Gains Tax Annual Allowance. Thirdly, he has lost the dividend rates on foreign dividends. Fourthly, s.809H(4) effectively denies him the benefit of double tax relief on the income he nominates.

Can Mr Chabal withdraw his claim? TMA s.33(2A)(c) prevents an error or mistake claim. But is a bad decision to make a claim an error or mistake within s.33 in any event? He could amend his return within TMA s.9ZA but only within twelve months of the filing date.

What would have happened if the nominated income had borne tax in excess of £30,000? Section 809C(4) would have had the result that the claim was invalid. The Financial Secretary to the Treasury said in the debates on the Finance Bill that taxpayers in these circumstances would be invited by HMRC to amend their return. That assumes that HMRC are capable of reliably identifying such cases.

SECTIONS 809I AND 809J: ORDER OF REMITTANCES

An Example

Mr A has the following income and capital gains in 2008/2009.

	Income and gains arising in the year £	Income and gains remitted in the year which have arisen in the current year[29] £	Foreign tax suffered £
UK trading income	50,000		
Foreign rental profits	50,000		
Foreign interest	50,000	10,000	
Foreign earnings	20,000		
Foreign dividends on minority holdings	30,000	30,000	20,000
Foreign dividends not on minority holdings	88,000	26,400	12,000
UK gains	10,000		
Foreign gains	90,000	18,000	10,000

Mr A's claim under s.809B for 2008/2009 nominates the whole of his foreign interest under s.809C(2). He was not aware that £10,000 of his interest had been remitted to the United Kingdom. Because it had been so remitted, s.809I applies and therefore s.809J applies to substitute a deemed order of remittance for the actual remittances.

If s.809I applies, the following steps are to be taken for the purpose of determining the income or gains treated in a tax year (the "relevant tax year") as remitted to the United Kingdom by the individual.

Step One – find the total amount of:-

(a) *The individual's nominated income and gains; and*
(b) *The individual's remittance basis income and gains*

that have been remitted to the United Kingdom in the relevant tax year. This amount is the "relevant amount".

[29] There are no remittances in respect of prior years' income and gains

		£
(a) =		10,000
(b) =	(£50,000[30] + £30,000[31] + £20,000[32])	100,000
		110,000

Step Two – find the amount of foreign income and gains of the individual for the relevant tax year (other than income or chargeable gains nominated under s.809C) that is within each of the categories of income and gains in paragraphs (a) to (h) of subsection (2). If none of ss.809B, 809D and 809E apply to the individual for that year, treat those amounts as nil (and accordingly go to step 6).

(a) =	Relevant foreign earnings (other than those subject to a foreign tax)	20,000	(foreign earnings)
(b) =	Foreign specific employment income (other than income subject to a foreign tax)	0	(none)
(c) =	Relevant foreign income (other than income subject to a foreign tax)	50,000	(rental profits)
(d) =	Foreign chargeable gains (other than gains subject to a foreign tax)	0	(none)
(e) =	Relevant foreign earnings subject to a foreign tax	0	(none)
(f) =	Foreign specific employment income subject to a foreign tax	0	(none)
(g) =	Relevant foreign income subject to a foreign tax	150,000	(foreign dividends)[33]
(h) =	Foreign chargeable gains subject to a foreign tax	100,000	(foreign chargeable gains)[34]

Step Three – find the earliest paragraph for which the amount determined under Step Two is not nil. If that amount does not exceed the relevant amount, treat the individual

[30] Foreign dividends and gains grossed up for foreign tax suffered
[31] Foreign dividends and gains grossed up for foreign tax suffered
[32] Foreign dividends and gains grossed up for foreign tax suffered
[33] Foreign dividends and gains grossed up for foreign tax suffered
[34] Foreign dividends and gains grossed up for foreign tax suffered

as having remitted the income or gains within that paragraph (and for that tax year). Otherwise, treat the individual as having remitted the relevant proportion of each kind of income or gains within that paragraph (and for that tax year. The "relevant proportion" is the relevant amount divided by the amount determined under Step Two of that paragraph.

£20,000 of the relevant amount of £110,000 is matched with foreign earnings.

Step Four – reduce the relevant amount by the amount taken into account under Step Three.

The relevant amount is reduced by £20,000 to £90,000.

Step Five – if the relevant amount (as reduced under Step Four) is not nil, start again at Step Three. In Step Three, read the reference to the earliest paragraph of the kind mentioned there as a reference to the earliest such paragraph which has not previously been taken into account under that step.

Steps Three and Four are repeated so that the relevant amount is matched with the foreign rental profits of £50,000. The remaining £40,000 of the "relevant amount" is matched pro rata with the foreign dividends.

Step Six – if the relevant amount (as reduced) is not nil once Steps Three to Five have been undertaken in relation to all paragraphs of subsection (2) for which the amount determined under Step Two is not nil, start again at Step 2.

The relevant amount is nil.

So Mr A's total remittances of £110,000 are deemed to be remittances of:-

	£
Foreign earnings	20,000
Foreign rental profits	50,000
Foreign dividends on minority holdings (£40,000 x 50/150)	13,333
Foreign dividends not on minority holdings (£40,000 x 100/150)	26,667
	110,000

What are the effects of ss.809I and 809J on Mr A's tax liability?

If ss.809I and 809J had not been enacted.

	£	£
Income Tax		
UK trading income		50,000
Foreign interest:-		
Actually remitted	10,000	
Nominated	40,000	
		50,000
Foreign dividends on minority holdings[35] 50,000 + (50,000 x 1/9)		55,555
Foreign dividends not on minority holdings[36]		30,000
		185,555
Income assessable under s.809H(4) (£30,000 – (£40,000 @ 40%)) x 10/4		35,000
		220,555

Tax thereon:-	£
34,800 @ 20%	6,960
185,755 @ 40%	74,302
	81,262
Less tax credit on foreign dividends from minority holdings	<5,555>
Double Tax Relief	
Foreign dividends on minority holdings restricted to ((55,555 @ 40%) – 5,555)	<16,667>
Foreign dividends not on minority holdings	<12,000>
Total liability	47,040

[35] Foreign dividends and gains grossed up for foreign tax suffered
[36] Foreign dividends and gains grossed up for foreign tax suffered

	£
Capital Gains Tax	
UK gains	10,000
Remitted foreign gains[37]	20,000
	30,000
Capital Gains Tax @ 18%	5,400
DTR	
10,000 x 10/100	<1,000>
	4,400
Total Income Tax and Capital Gains Tax	
Income Tax	47,040
Capital Gains Tax	4,400
	51,440

Actual Tax Liability

	£	
Income Tax		
UK trading income	50,000	
Foreign earnings	20,000	
Foreign rental profits	50,000	
Foreign dividends on minority holdings	13,333	
Foreign dividends not on minority holdings	26,667	
Nominated income (foreign interest)	50,000	
Income assessable under s.809H(4) (30,000 – (50,000 @ 40%)) x 10/4	25,000	
	235,000	
Tax thereon:-		
34,800 @ 20%		6,960
200,200 @ 40%		80,080
		87,040

[37] Foreign dividends and gains grossed up for foreign tax suffered

Less tax credit on foreign dividends on minority holdings	<1,333>
Double Tax Relief	
Foreign dividends on minority holdings restricted to ((13,333 @ 40%) – 1,333)	<4,000>
Foreign dividends not on minority holdings 26,667 x 12,000 / 100,000	<3,200>
	78,507
Capital Gains Tax	
UK gains	10,000
Tax thereon @ 18%	1,800
Total Income Tax and Capital Gains Tax	
Income Tax	78,507
Capital Gains Tax	1,800
	80,307
Less liability which would have arisen but for ss.809I & 809J	51,440
Increase in liability due to ss.809I & 809J	28,867

SECTIONS 809Q AND 809R: MIXED FUNDS

Mixed Funds

Sections 809Q and 809R contain rules for determining the composition of transfers from mixed funds.

Section 809Q

Section 809Q applies only where Condition A in s.809L is met and:-

> *"(a) the property or consideration for the service is (wholly or in part) or derives (wholly or in part, and directly or indirectly) from, a transfer from a mixed fund, or*
> *(b) a transfer from a mixed fund, or anything deriving (wholly or in part, and directly or indirectly) from such a transfer, is used as mentioned in section 809L(3)(c)."*

Where the section applies it applies only for the purposes of determining whether Condition B in s.809L is met and if it is met, determining (under s.809P) the amount of income or chargeable gains remitted.

It is important to appreciate, therefore, that the rules in s.809Q only apply for very limited purposes.

Where the section applies subsection (3) provides a five-step process for determining the composition of the transfer from the mixed fund.

Section 809R

Section 809R also applies for narrow purposes. It applies only for the purpose of Step One in s.809Q(3), under which, for each of the categories of income and capital set out in subsection (4) of s.809Q, one finds the amount of income or capital of the individual for the relevant tax year which is in the mixed fund immediately before the transfer.

As we have seen, s.809Q only applies where there is a transfer from a mixed fund (subsection (1) ibid). Subsection (6) ibid defines a mixed fund as:-

> *"… money or other property which immediately before the transfer contains or derives from-*
>
> *(a) more than one of the kinds of income and capital mentioned in subsection (4), or*
> *(b) income or capital for more than one tax year."*

Because s.809R applies only for the purposes of Step One of s.809Q(3) it does not apply for the purposes of s.809Q(1) and (6). Therefore, in deciding whether one has a mixed fund at all, on a literal construction, one cannot apply the rules for determining the composition of the fund which are contained in s.809R. Where s.809R applies, the following rules are to be followed under Step One of S.809R (3):-

> *"(2) Treat property which derives wholly or in part (and directly or indirectly) from an individual's income or capital for a tax year as consisting of or containing that income or capital.*
>
> *(3) If a debt relating (wholly or in part, and directly or indirectly) to property is at any time satisfied (wholly or in part) by –*

(a) an individual's income or capital for a tax year, or
(b) anything deriving (directly or indirectly) from such income or capital,

from that time treat the property as consisting of or containing the income or capital if and to the extent that it is just and reasonable to do so.

(4) Treat an offshore transfer from a mixed fund as containing the appropriate proportion of each kind of income or capital in the fund immediately before the transfer.

"The appropriate proportion" means the amount (or market value) of the transfer divided by the market value of the mixed fund immediately before the transfer.

(5) A transfer from a mixed fund is an "offshore transfer" for the purposes of subsection (4) if and to the extent that section 809Q does not apply in relation to it.

(6) Treat a transfer from a mixed fund as an "offshore transfer" (and section 809Q as not applying in relation to it, if it otherwise would do) if and to the extent that, at the end of a tax year in which it is made –

(a) section 809Q does not apply in relation to it, and
(b) on the basis of the best estimate that can reasonably be made at that time, section 809Q will not apply in relation to it.

(7) In this section 'mixed fund' means money or other property containing or deriving from –

(a) more than one of the kinds of income and capital mentioned in section 809Q(4), or
(b) income or capital for more than one tax year.

(8) If section 809Q applies in relation to part of a transfer, apply that section in relation to that part before applying subsection (4) in relation to the rest of the transfer.

(9) If section 809Q applies in relation to more than one transfer from a mixed fund, when undertaking step 1 in relation to the second or any subsequent transfer take into account the effect of step 2 of section 809Q(3) (composition of transfer) as it applied in relation to each earlier transfer."

Having provided very detailed computational rules for determining the composition of transfers from mixed funds the draughtsman has then included a mini-general anti-avoidance rule (the "Mini GAAR") in s.809S which provides as follows:-

"(1) This section applies if, by reason of an arrangement the main purpose (or one of the main purposes) of which is to secure an income tax advantage or capital gains tax advantage, a mixed fund would otherwise be regarded as containing income or capital within any of paragraphs (f) to (i) of section 809Q(4).

(2) Treat the mixed fund as containing so much (if any) of the income or capital as is just and reasonable.

(3) "Arrangement" includes any scheme, understanding, transaction or series or transactions (whether or not enforceable).

(4) "Income tax advantage" has the meaning given by section 683.

(5) "Capital gains tax advantage" means –

(a) a relief from capital gains tax or increased relief from capital gains tax,
(b) a repayment of capital gains tax or increased repayment of capital gains tax,
(c) the avoidance or reduction of a charge to capital gains tax or an assessment to capital gains tax, or
(d) the avoidance of a possible assessment to capital gains tax."

AN EXAMPLE OF THE APPLICATION OF SECTIONS 809Q & 809R

Mr Van Heerden set up a Jersey Bank Account (the "A Account") on the 31st March 2005. He transferred all of his money into this account, being £2m. On the same day he also established another account (the "B Account") without placing any money in it at that time. He earmarked the B Account for his foreign source income.

He instructed his bankers that when interest was credited annually to the A account it was to be transferred on the same day to the B Account. The following interest was credited to the A Account in this way and then transferred to the B Account:-

30th April	**£**
2005	10,000
2006	120,000
2007	100,000

This interest was not subject to foreign tax.

Until this time he had not been resident or ordinarily resident in the United Kingdom but he became so on the 6th April 2005.

On the 30th June 2006 Mr Van Heerden made a disposal of foreign situated assets, receiving proceeds of £500,000 which he paid into the A Account and realised a gain of £100,000. This gain was subject to foreign tax.

On the 30th June 2007 he received a dividend of £500,000 from a UK company and paid that dividend into his A Account.

On the 31st March 2008 he closed the A Account transferring the balance of £3,090,000 to a new Jersey Account (the "C Account"). The balance transferred included £90,000 of interest which was credited to the account on its closing.

He instructed the bank that any interest arising in respect of the balance on the C Account should be credited to his B Account.

On the 15th April 2008 he paid a cheque of £1m in respect of a foreign dividend into his C Account. In completing the instruction to his bankers he had inadvertently given the account number of his C Account instead of that of the B Account. This dividend was subject to foreign tax.

On the 30th April 2008 he transferred £500,000 from the A Account to his wife's Isle of Man account.

On the 31st May 2008 he transferred £250,000 to a new account in the Isle of Man which he had established.

On the 30th June 2008 he transferred £1m from the A Account to his UK bank account.

How do ss.809Q and 809R apply to these transactions?

The Transfers on the 30th April 2008 and 31st May 2008

Condition A of s.809L is not satisfied in respect of the moneys transferred to Mr Van Heerden's wife so s.809Q does not apply. Similarly, Condition A is not satisfied in relation to the moneys transferred to Mr Van Heerden's Isle of Man account on the 31st May 2008 and so again s.809Q does not apply to that transfer.

The Transfer of 30th June 2008 to Mr Van Heerden's UK Bank Account

The transfer on the 30th June 2008 to Mr Van Heerden's UK bank account satisfies Condition A because money was brought to the United Kingdom by a relevant person. We shall assume that the property, the money transferred, is a transfer from a mixed fund within s.809Q(1)(a). Therefore, in determining whether Condition B is met we must apply the five steps set out in s.809Q(3).

Step 1

For each of the categories of income and capital in paragraphs (a) to (i) of subsection (4), find (applying section 809R) the amount of income or capital of the individual for the relevant tax year in the mixed fund immediately before the transfer. "The relevant tax year" is the tax year in which the transfer occurs.

The opening balance of Account C was received from Account A on the 31st March 2008. That was not a transfer to which Section 809Q applied and so under s.809R(5) it was an offshore transfer. Therefore, one must treat the transfer from the A Account to C Account as containing "the appropriate proportion of each kind of income or capital in the fund immediately before the transfer." As the whole fund was transferred the appropriate proportion is one.

So the question is: what kinds of income and/or capital did the A Account hold immediately before the transfer on the 31st March 2008?

Section 809R tells one to treat property which derives wholly or in part (and directly or indirectly) from the individual's income or capital for the tax year as consisting of or containing that income or capital. So if we can say that the balance on the A Account derived from Mr A's income or capital wholly or in part we must treat the account as consisting of or containing that income or capital.

The account must derive from the money paid into it, except to the extent that those moneys have been paid out of it. How are we to match transfers out of the account with transfers into it? The answer is that if those transfers are not transfers within s.809Q, which they will only be if Condition A of s.809L is met in respect of the transfer concerned, then they are offshore transfers and they consist of the appropriate proportion of each type of income and capital in a mixed fund under subsection (4) ibid.

The only transfers out of the C Account before the closing transfer were the transfers of interest. Because of Mr Van Heerden's instruction to his bankers, that interest was first to be credited to the account and was then to be transferred to the B Account. The result of subsection (4) is that the transfers in respect of that interest did not consist wholly of interest for the purposes of s.809R. We therefore need to work out what was transferred on each occasion on which there was a transfer in respect of interest.

Date	Transaction	Capital	Foreign interest	Foreign capital gains	UK dividend income	Net movement	Balance
31/03/2005	Opening capital	2,000,000				2,000,000	2,000,000
30/04/2005	Interest credited		10,000			10,000	2,010,000
30/04/2005	Transfer to B Account	<9,950>	<50>			<10,000>	2,000,000
		1,990,050	9,950	-	-	2,000,000	2,000,000
30/04/2006	Interest credited		120,000	-	-	120,000	2,120,000
30/04/2006	Transfer to B Account	<112,644>	<7,356>	-	-	<120,000>	2,000,000
		1,877,406	122,594	-	-	2,000,000	2,000,000
30/06/2006	Capital proceeds credited	400,000		100,000	-	500,000	2,500,000
30/04/2007	Interest credited		100,000		-	100,000	2,600,000
30/04/2007	Transfer to B Account	<87,593>	<8,561>	<3,846>	-	<100,000>	<2,500,000>
		2,189,813	214,033	96,154	-	2,500,000	2,500,000
30/06/2007	UK dividend receipt				500,000	500,000	3,000,000
31/03/2008	Interest credited		90,000			90,000	3,090,000
31/03/2008	Transfer to C Account	<2,189,813>	<304,033>	<96,154>	<500,000>	<3,090,000>	0
		0	0	0	0	0	0

So we have now determined the composition of the opening balance on the C Account and we can apply the like process to determining the composition of the account immediately before Mr A's transfer to his UK bank account on the 30th June 2008.

Date	Transaction	Capital	Foreign interest without foreign tax	Foreign capital gains with foreign tax	UK dividend	Foreign dividend with foreign tax	Net movement	Balance
31/03/08	Opening balance	2,189,813	304,033	96,154	500,000	0	3,090,000	3,090,000
15/04/08	Foreign dividend rec'd					1,000,000	1,000,000	4,090,000
15/04/08	Transfer to wife	<267,703>	<37,168>	<11,755>	<61,125>	<122,249>	<500,000>	3,590,000
		1,922,110	266,865	84,399	438,875	877,751	3,590,000	3,590,000
31/05/08	Transfer to IOM Account	<133,852>	<18,584>	<5,877>	<30,562>	<61,125>	<250,000>	3,340,000
		1,788,258	248,281	78,522	408,313	816,626	3,340,000	3,340,000

So the amounts of income and capital within each of the categories given in subsection (4) were as follows:-

		£
(a)	employment income (other than income within paragraph (b), (c) or (f))	0
(b)	relevant foreign earnings (other than income within paragraph (f))	0
(c)	foreign specific employment income (other than income within paragraph (f))	0
(d)	relevant foreign income (other than income within paragraph (g))	248,281
(e)	foreign chargeable gains (other than chargeable gains within paragraph (h))	0
(f)	employment income subject to a foreign tax	0
(g)	relevant foreign income subject to a foreign tax	816,626
(h)	foreign chargeable gains subject to a foreign tax	78,522
(i)	income or capital not within another paragraph of this subsection	2,196,571
		3,340,000

Step 2

Find the earliest paragraph for which the amount determined under step 1 is not nil. If that amount does not exceed the amount of the transfer, treat the transfer as containing the income or capital within that paragraph (and for that tax year). Otherwise, treat the transfer as containing the relevant proportion of each kind of income or capital within that paragraph (and for that tax year). "The relevant proportion" is the amount of the transfer divided by the amount determined under step 1 for that paragraph.

The earliest paragraph is Category (d) and so the £1m transferred is treated as containing £248,281 of the foreign interest which had been credited to the A Account.

Step 3

Treat the amount of the transfer as reduced by the amount taken into account under step 2.

The transfer of £1m is reduced by £218,281 to £751,719.

Step 4

If the amount of the transfer (as reduced under step 3) is not nil, start again at step 2. In step 2, read the reference to the earliest paragraph of the kind mentioned there as a reference to the earliest such paragraph which has not previously been taken into account under that step in relation to the transfer.

The amount of the transfer has not been reduced to nil so one starts again at Step 2. This time, the earliest paragraph for which the amount determined under Step 1 is not nil is paragraph (g). That amount exceeds the remaining balance of the transfer and so one treats the transfer as containing the relevant proportion of each kind of income or capital within that paragraph and for that tax year. Thus, the remaining transfer of £751,719 is matched with the foreign dividend. The amount of the transfer is then reduced by the amount matched with the foreign dividend to nil.

Step 5

If the amount of the transfer (as reduced under step 3) is not nil once steps 2 and 3 have been undertaken in relation to all paragraphs of subsection (4) for which the amount determined under step 1 is not nil, start again at step 1.
In step 1, read the reference to the relevant tax year as a reference to the tax year immediately before the last tax year for which step 1 has been undertaken in relation to the transfer.

The amount of the transfer as reduced is nil.

So Mr Van Heerden's transfer on the 30th June 2008 to his UK bank account consisted of foreign interest which had not borne foreign tax of £248,281 and foreign dividends of £751,719 which had borne foreign tax.

SECTION III

A DARK WOOD WHERE THE STRAIGHT WAY WAS LOST[38]

The taxpayer's appeal in *Underwood v HMRC* from the decision of the High Court has been heard by the Court of Appeal. We examined the decisions of the Special Commissioner and of the High Court in our article *"Mysterium sub Silua"* which appeared in our last issue.[39] In that article it was said that the case brings "sharply to the fore the question of what exactly is a disposal for Capital Gains Tax purposes" and explained that the High Court's decision, if it stood, would have:-

> " … profound effects upon two categories of very common transactions. It is to be hoped that it will be appealed so as to provide clarity both on the narrower issue of the taxation of contracts where, due to the interaction with another contract, the purchaser does not receive an unfettered right to the subject matter of the contract and on the wider issue of the nature of a disposal for capital gains tax purposes."

THE DECISION

The Court of Appeal's decision has now been published[40] and was again in favour of HMRC. It is disappointing, to say the least.

The leading judgment was delivered by Collins LJ. Goldring LJ simply agreed with that judgment without further comment whilst Lord Neuberger agreed with Collins LJ in a two-page judgement which he described as "no more than a coda to the more fully expressed judgement of Collins LJ, with which I wholly agree …"[41]

A QUESTION OF IMPORTANT PRINCIPLE?

Collins LJ says in his introductory remarks that:-

> "The appeal does not raise any issue of principle, but concerns the (by no means easy) task of characterising, as a matter of law, what the parties did or must be taken to have done when the tripartite transaction was effected in 1994."[42]

---

38 Dante Alighieri, Divina Commedia, Inferno, Canto 1 line 1

39 Although the facts of the case were set out in the Rudge Revenue Review Issue 4, for readers' convenience a summary is given in the box at the end of this article (to which reference should also be made for definitions of the terms used in this article).

40 *Underwood v Commissioners for Her Majesty's Revenue & Customs* [2008] EWHC Civ 1423. The reference for the High Court decision is [2008] EWHC 108(Ch) and for the Special Commissioner's decision is [2007] STC (SCD) 659. In this article the Court of Appeal, High Court and Special Commissioner's decisions are referred to respectively as the "Court of Appeal Decision", the "High Court Decision" and the "Special Commissioner's Decision"

41 Paragraph 69. All references in this article are to the All England Report of the case unless otherwise stated

42 Paragraph 7

So the reader knows almost immediately that it is unlikely that the judgment will deal adequately with the fundamental issues at stake in the case.

THE SPECIAL COMMISSIONER'S REASONING CONFIRMED

As we explained in Issue 4 of the Rudge Revenue Review both the Special Commissioner and the High Court took as their starting point that a disposal for Capital Gains Tax purposes is the transfer of a beneficial interest in the subject matter of the disposal from one person to another. They both concluded that Mr Underwood's transactions did not constitute a disposal under the 1993 contract but they did so on significantly different grounds. The Special Commissioner accepted that the transactions taking place on 30th November 1994 completed both the 1993 Contract, the Resale Contract and the Brickfields Contract but held that there was no transfer of a beneficial interest in the property from Mr Underwood to Rackham Ltd under the 1993 Contract because:-

> "… [T]here was no moment in time when the rights in the Property vested in Rackham Ltd because the very event which constituted payment by Rackham Ltd of the consideration under the contract also constituted payment by [Mr Underwood] under the [Re-Sale] Contract made … in exercise of the option. The payment being by set-off there was not and could not be a moment in time when Rackham Ltd paid the appellant but the appellant had not paid Rackham Ltd."[43]

In the High Court, however, Mr Justice Briggs held that neither the 1993 Contract nor the Resale Contract had been completed and it was for this reason that there was no transfer of the beneficial interest in the property under either Contract.[44]

In stating his decision, Collins LJ specifically approved as correct "the reasoning of the Special Commissioners"[45] but confusingly, in apparent contradiction of the Special Commissioners, he stated that:-

> "Mr Cunningham did not complete the sale of the property to Rackham Ltd and the Option was not actually exercised."[46]

Lord Neuberger, who said that he wholly agreed with Collins LJ judgement,[47] specifically endorsed the Special Commissioner's reasoning rather than that of Mr Justice Briggs:-

> "To that extent, I would agree with the Special Commissioners rather than Briggs J (although the difference between their respective analyses is very refined and pretty slight). While, as Briggs J said, it is a somewhat artificial analysis, the two contracts between Mr Underwood and Rackham Ltd were, in my opinion, performed, rather than cancelled, by the payment of the £20,000."[48]

---

43 Special Commissioner's Decision at 668
44 High Court Decision at 1156 and 1157
45 Paragraph 55
46 Paragraph 48
47 Paragraph 70
48 Paragraph 65

The outcome of the Appeal, therefore, seems to be consistent with the expectations which I expressed in our previous article:-

> "... the High Court's decision surely cannot stand, because it is based on a substitution of the facts found by Briggs J. for the facts found by the Special Commissioners and not on an application of the law to the facts found by the fact-finding tribunal.
>
> That may not help Mr Underwood, however, because, contrary to Briggs J.'s view, there is no logical contradiction between the fact that Rackham Ltd did not obtain a beneficial interest in the Property and that payments were made under the contracts by way of set-off …. It seems clear to the author that both contracts were …. performed. Unfortunately for Mr Underwood, the mode of performance did not involve Rackham Ltd acquiring a beneficial interest in the Property for even a *scintilla temporis* except a limited and temporary interest under the doctrine of the estate contract and, on the admittedly rather opaque authority of *Jerome v Kelly (Inspector of Taxes),* that did not constitute a disposal."

WHAT IS A DISPOSAL?

In his judgment Collins LJ does pose the question which is crucial to the case:-

> "What then is a disposal of land for the purposes of capital gains tax?"[49]

His consideration of that question, however, is cursory. He concludes it by recording that:-

> " … it was common ground in this Appeal that … [a disposal] … meant the disposal of the entire beneficial interest in the assets."[50]

He does not examine the case authority for this definition of a disposal. No doubt a disposition involving the transfer of the entire beneficial ownership of an asset is a disposal for Capital Gains Tax purposes but holding that only such a disposition can be a disposal raises severe difficulties.

DIFFICULTIES WITH THE DEFINITION

If there is only a disposal where the entire beneficial interest in an asset has been transferred, how can one have a part disposal within s.21(2)(a)? For under Collins LJ's definition if the entire beneficial interest in the asset were not transferred there would be no disposal at all and not a disposal of part of the asset. So it appears that under Collins LJ's definition the grant by a freeholder of a tenancy in common would not be a disposal. Even if one accepts the argument that the word "disposal" in the phrase "part disposal" in s.21(2)(a) bears a different meaning to its meaning when it is used without the adjective in the same sub-section so that the transfer of a beneficial interest in less than the whole of an asset would constitute

[49] Paragraph 39
[50] Paragraph 40

a disposal, it would then be difficult, as explained in our previous article, to reconcile the decision in *Jerome v Kelly*[51] with the doctrine of the Estate Contract and with *Lysaght v Edwards*[52] in particular.

BED AND BREAKFAST AND SUB-SALE TRANSACTIONS

A major difficulty with Collins LJ's definition of a disposal and his application of it to the 1993 Contract is that it has the result of overturning the long-established and accepted treatment of bed and breakfast transactions and of sub-sales.

In our previous article we pointed out that the same reasoning that led the Special Commissioners (and now Collins LJ) to conclude that there had been no disposal by Mr Underwood to Rackham Ltd under the 1993 Contract would also lead to the conclusion that there are no disposals in the common form of bed and breakfast contractions and only a single disposal from the original vendor to the final purchaser in sub-sale transactions. Indeed, Counsel for Mr Underwood made this very point in the Court of Appeal. Neither Collins LJ nor Lord Neuberger made more than a cursory examination of the implications of their decisions for these two very common forms of transactions.

Bed and breakfast transactions

Collins LJ merely said in relation to bed and breakfast transactions:-

> "I do not consider that Mr Underwood is assisted by reliance on other types of transaction which are said to be similar. In "bed and breakfast" transactions the owner of the asset disposes of it and then re-acquires it: *MacNiven v Westmoreland Investments* [2001] UKHL 6, (1998) 73 TC 1, 48, affd [2003] 1 AC 311."[53]

This comment simply begs the question. As we pointed out in our previous article, in the conventional form of bed and breakfast transaction, two contracts for the sale and purchase of securities are settled, just as the 1993 Contract and the Resale Contract were settled, by setting off against each other the equal and opposite obligations under the two Contacts to transfer the subject matter of the Contract and by setting off the obligations under the two Contracts to make payments with the result that no transfer of the subject matter of the Contracts is made and only a net sum is paid. These are the very characteristics that led the Special Commissioner, Collins LJ and Lord Neuberger to conclude that no disposal had been made under the 1993 Contract. In distinguishing bed and breakfast transactions from Mr Underwood's transactions on the basis that in the former, "the owner of the asset disposes of it" Collins LJ begs the very question which has to be answered.

Similarly, Lord Neuberger says:-

---

51 *Jerome v Kelly* [2004] STC 887
52 *Lysaght v Edwards* [1875-76] LR 2 ChD 499
53 Paragraph 54

> "I should also mention Mr Soares's point that, if we dismiss this appeal, it would call into question the validity of the standard "bed and breakfast" arrangements entered into by the holder of an asset (normally a parcel of shares) to crystallise a capital loss by selling, and immediately repurchasing, the asset. In such cases, there are two reciprocal transactions, under which the original holder of the asset can fairly be said to dispose of his interest in the asset, and immediately thereafter to re-acquire it."[54]

This begs the question of why, in bed and breakfast transactions, "the original holder of the assets can fairly be said to dispose of his interest in the asset." What are the characteristics of a bed and breakfast transaction which are not found in Mr Underwood's transactions that allows one to come to that conclusion? It is clear that there are none. As we said in our previous article:-

> "It is difficult to see, however, why, if the arrangements for the settlement of the 1993 Contract and the Re-Sale Contract in *Underwood* did not amount to performance of those contracts, the settlement of the bed and breakfast transactions by set-off of both the obligations to pay and the obligations to deliver securities should not also be insufficient to amount to performance. If the Special Commissioners' reasoning is restored, [as it has been by the Court of Appeal] it is clear that it must also apply to bed and breakfast transactions because in such transactions there is no point in time at which the institution can call for delivery of the shares from the taxpayer."

Sub-Sales

Again, Collins LJ's conclusions in relation to sub-sales are simply circular. He distinguishes sub-sales from Mr Underwood's transactions on the basis that in sub-sales there are two disposals.[55] Lord Neuberger's consideration of sub-sales is only slightly fuller:-

> "I also accept that, where an asset is the subject of an initial contract and a sub-contract, and, on completion of the two contracts, the buyer directs the seller to transfer direct to the sub-buyer, there are two disposals, one under each contract. However, that is because it can fairly be said that the asset is disposed of under each contract, albeit that the mechanics of the transaction involve an acceleration, or conflation, of the two disposals. The essential point is that, on completion, as between the buyer and seller, the asset is "disposed of and acquired under the [initial] contract" (and, indeed, under the sub-contract) whereas that cannot be said about the Property under the 1993 contract (or, indeed, under the 1994 contract). An important difference between the sub-sale case and this case is that, here, the contractual arrangements between Mr Underwood and Rackham Ltd formed no part of the contractual chain, or what one might call the chain of equitable title, between the initial seller of the Property (Mr Underwood) and its ultimate buyer (Brickfields). Thus, Rackham Ltd, unlike the buyer/sub-seller in the sub-sale case, was not in a position to direct the sale of the Property to Brickfields (or, thus, to turn the Property to account)."[56]

---

54 Paragraph 66
55 Paragraph 54
56 Paragraph 67

So Lord Neuberger concludes that there are two disposals in a sub-sale "one under each contract" because "… it can fairly be said that the asset is disposed of under each contract." That is obviously a circularity.

Lord Neuberger considers that the key question is whether there is an asset which is disposed of and acquired at the date of completion:-

> "[Counsel for the taxpayers] argument rests, indeed depends on, on an asset being disposed of and acquired at the date of completion as opposed to the date of contract."[57]

In Lord Neuberger's view as in the view of the Special Commissioner, for there to be a disposal, completion of the contract must vest a beneficial interest in its subject matter in a person other than the disponer for at least a moment. In a typical sub-sale contract where contracts between A and B and between B and C for the sale of a property are completed by a transfer of the property from A to C and simultaneous payment of the consideration under the contracts partly by way of set-off, there will be no moment at which B can call for a transfer of the property from A. B, to adopt Lord Neuberger's words, is never in a position to direct the sale of the propety to C although he is in a position to enter into a sales contract with C in respect of the property just as Rackham Ltd entered into a contract to sell the property back to Mr Underwood and might just as well have entered into a contract to sell the property to Brickfields. The important point is that B does not acquire at any time an interest in the property other than an interest under the doctrine of the Estate Contract because he does not have a right to call for the transfer of the property to him before the Contract is completed and, at the moment that the Contract is completed, it is completed by transferring the property direct to C in satisfaction of C's contractual right against B.

The Special Commissioner's explanation of why the effect of the 1993 Contract and the Re-Sale Contract taken together was that Rackham Ltd did not acquire at any time a beneficial interest in the property is quoted above. If one simply substitutes in that passage the parties under a typical sub-sale transaction one can see that the same reasoning leads to the conclusion that B does not make a disposal.

> "… [T]here was no moment in time when the rights in the Property vested in [B] because the very event which constituted payment by [B] of the consideration under the [First] contract also constituted payment by [C] under the [Second] Contract. The payment being by set-off there was not and could not be a moment in time when [B] paid … [A] but [C] had not paid [B]."

Of course, the fact that, if one were to apply the ratio decidendi in *Underwood*, the most common forms of bed and breakfast and sub-sale transactions would have very different tax consequences from those which have been assumed to apply for the entire time that Capital Gains Tax has existed, does not of itself have the result that the decision is incorrect.

---

[57] Paragraph 62

A FOG OF UNCERTAINTY

At the very least, however, the implications of the decision for the coherence of Capital Gains Tax and of the taxation of these very common forms of transactions should have received more substantial consideration by the Court of Appeal.

Collins LJ's failure to recognise that the case depended upon a fundamental principle of Capital Gains Tax and the unlikelihood that the taxation of two common classes of transactions has been fundamentally misunderstood throughout the history that tax should surely have been sufficient for the House of Lords to grant leave to appeal. We understand, however, that leave to appeal to the House of Lords has not been granted. It is regrettable that the House of Lords has refused this opportunity to resolve the conceptual incoherence caused by the Court of Appeal's decision. Those trying to ascertain how transactions under an executory contract providing for the transfer of the subject matter of the contract to the purchaser which, because of its interaction with another contract, does not take place will now be subject to considerable uncertainty. Lord Justice Collins and Lord Neugerger's comments on sub-sale transactions will provide little comfort, begging, as they do, the essential question at issue in the case.

The Dramatis Personae

The dramatis personae in the case were Mr Underwood and two companies which he controlled, being Brickfields Estate Limited (Brickfields) and Mac Estates Limited (Mac Estates) and Mr Rackham and two companies which he controlled, being Anti-Waste Limited (Anti-Waste) and Rackham Limited.

The Facts

Mr Underwood's purchase of the Property

On 24th May 1990 Anti Waste sold a commercial property (the "Property") to Mr Underwood for £1.4m. His acquisition was partially financed with a £1m mortgage from a bank (the Bank) secured on the Property.

The 1993 Contract

On the 2nd April 1993 Mr Underwood entered into a contract (the '93 Contract) with Rackham Ltd for the sale of the Property for £400,000 with a completion date of the 31st December 1993.

The Option

Also on the 2nd April 1993 Rackham Ltd granted an option (the Option) to Mr Underwood under which he had the right to re-purchase the Property at any time before the 31st December 1995. The exercise price was to be £400,000 plus the cost of any capital improvements made by Rackham Ltd and ten per

cent of the difference between the value of the property at the date of the option agreement and its value at the date of exercise. Completion was to be twenty eight days after the date of exercise.

On the 28th April 1993 the Property was valued at £400,000 on the open market and at £290,000 in the event of a forced sale.

The return for 1992/1993

In his tax return for the fiscal year 1992/1993 Mr Underwood claimed a loss on this transaction of £1,174,677.

Delayed completion of the '93 Contract

The Bank would not permit the sale to Rackham Ltd to proceed until the loan was repaid and so Rackham Ltd and Mr Underwood agreed to extend the completion date of the '93 Contract to 31st December 1994.

Negotiating a re-financing

It appears that Mr Underwood then negotiated a re-financing of his obligations.

A Building Society (the First Building Society) agreed to loan £1.25m to Mac Estates secured by a charge on a property owned by that company. Another Building Society (the Second Building Society) agreed to grant a loan of £355,000 to Brickfields secured on the Property. It was a requirement of both loans that the Property should be sold to Brickfields and the loans were only to be released when that happened.

The Re-Sale Contract

Mr Underwood determined to exercise the Option so as to be in a position to sell the Property to Brickfield.

Peculiarly, Mr Underwood did not give notice under the Option but rather a new agreement (the Re-Sale Contract) was made between Mr Underwood and Rackham Ltd dated 29th November 1994 under which Rackham Ltd agreed to sell the property to Mr Underwood for £420,000. This amount was calculated as being ten per cent of the increase in the value of the property between the date of the option (£400,000) and the date of the re-sale contract (£600,000).

The Brickfields Contract

Also on 29th November 1994, the appellant entered into another contract (the Brickfields Contract) under which he agreed to sell the property to Brickfields

for the sum of £600,000. At this stage the date of completion of the '93 Contract was 31st December 1994 and of the Re-Sale Contract and the Brickfields Contract was 19th December 1994.

The completion(s)?

On 30th November 1994 Mr Underwood executed a transfer of the Property directly to Brickfields in consideration of the sum of £600,000. On the same day Brickfields mortgaged the Property to the Second Building Society and received £353,000 from them. At 'about the same time' Mac Estates mortgaged its property to the First Building Society and received a mortgage loan from it 'of which £250,000 was available to redeem the loan on the Property'. £640,000 was paid to the Bank with Mr Underwood finding the balance of £37,000 (£640,000 - £353,000 - £250,000) from his own resources. The Bank then released its charge on the Property. Mr Underwood did not pay the £20,000 to Rackham Ltd until 4th December 1996, Rackham Ltd's books showing a debtor for that amount in the meantime.

The 1993/1994 and 1994/1995 Returns

Mr Underwood made no chargeable gains in 1993/1994 and therefore carried forward the unrelieved 1993 losses to 1994/1995 when he set off the greater part of them against chargeable gains.

The assessments

The Revenue's position was that there was no disposal under the '93 Contract but only under the Brickfields Contract. The result of that, presumably, was that Mr Underwood did not make a capital loss in 1992/1993 and in 1994/1995 Mr Underwood would have made a loss of £800,000 (£1.4m - £600,000) plus an amount equal to the applicable indexation relief and the incidental costs of acquisition and disposal. This loss, however, was a loss on a disposal to a connected person and therefore, by virtue of TCGA 1992 s.18, was only off-settable against other disposals to Brickfields.

McKie & Co Limited
McKie & Co (Advisory Services) LLP
Rudge Hill House
Rudge
Somersetshire
BA11 2QG
Tel: 01373 830956
Fax: 01373 830326
Email: enquiries@mckieandco.com